

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 98-0429
Indiana Corporation Income Tax
For Years 1994, 1995, and 1996

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ISSUES

I. Foreign Source Dividends Expenses.

Authority: IC 6-3-2-12.

The taxpayer protests the Department's determination to apply expenses related to foreign source dividends to that dividend income in order to fairly reflect the taxpayer's Indiana activities. The taxpayer argues that no authority supports this adjustment and that foreign source dividend expenses should not be included within the taxpayer's income.

II. Equitable Adjustment to Sales Factor Denominator: Exclusion of Certain Gross Receipts from the Sales Factor Denominator.

Authority: 45 IAC 3.1-1-50.

The taxpayer protests the Department's determination that certain dividends and U.S. interest income should be excluded from the denominator of taxpayer's Indiana sales factor thereby resulting in additional tax liabilities. The taxpayer argues that this action is in direct contrast to actions taken by the prior auditor and that the inclusion of all gross receipt items within the sales factor denominator is consistent with the Indiana statutes and does not result in an arbitrary division of income.

III. Addback of State Taxes Based On Or Measure by Income: Michigan Single Business Tax.

Authority: IC 6-3-1-3.5(b); IC 6-3-2-1(b); First Chicago NBD Corp. v. Dept. of State Revenue, 708 N.E.2d 631 (Ind. Tax Ct. 1999); 45 IAC 45 IAC 3.1-1-8(3)(a).

Taxpayer protests the auditor's determination that the Michigan Single Business Tax is a tax sufficiently based on or measured by income such that the tax must be added back for purposes of determining taxpayer's liability under Indiana's adjusted gross income tax. Taxpayer argues that the tax does not meet the definition of a tax based on or measured by income and therefore, no addback of the Michigan Single Business Tax is required to calculate taxpayer's adjusted gross income.

IV. Equitable Abatement of Accumulated Interest.

Authority: IC 6-8.1-10-1.

The taxpayer argues that, based upon the lengthy delay in responding to the taxpayer's protest, the Department should exercise its powers to abate the accumulated interest on any tax liability found due.

STATEMENT OF FACTS

The taxpayer is a large, out-of-state, manufacturer of candy. Taxpayer markets its products throughout the United States but does not operate a plant or business location in Indiana. Taxpayer's Indiana employees, operating out of their homes, contact customers and potential customers. Taxpayer's Indiana assets consist of vehicles provided to its employees and to small amounts of inventory held by the individual employees.

DISCUSSION

I. Foreign Source Dividends Expenses.

Taxpayer argues that the Department erred in requiring it to adjust its gross income by adding back foreign source dividend expenses. The taxpayer maintains that no legal authority supports such a requirement.

The auditor determined that these expenses should be applied to the foreign source dividend income to "fairly reflect Indiana adjusted gross income as required by the Department." Audit Summary, p. 5.

Pursuant to IC 6-3-2-12, taxpayer deducted foreign source dividend income from its Indiana adjusted gross income. The audit disagreed with the taxpayer's method of doing so and adjusted the deduction to take into account expenses associated with the accumulation of that foreign source dividend income.

IC 6-3-2-12(b) states that "A corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is entitled to a deduction from that adjusted gross income. The amount of the deduction equals the product of the amount of the

foreign source dividend included in the corporation's adjusted gross income for the taxable year; multiplied by the percentage prescribed in subsection (c), (d), or (e), as the case may be."

The aforementioned subsections (c), (d), and (e) allow corporate taxpayers to receive a one hundred percent deduction for foreign source dividends received from corporations in which a taxpayer has an eighty percent (80%) or larger ownership interest; an eighty-five percent (85%) deduction for dividends received from corporations in which a taxpayer has a fifty to seventy-nine percent (50% to 79%) ownership interest; and a fifty percent (50%) deduction for dividends received from corporations in which the taxpayer has less than a fifty percent (50%) ownership interest. IC 6-3-2-12(c)-(e).

The statutory language is straightforward. IC 6-3-3-12 authorizes pro rata deductions (based upon the percentage ownership of the payor by the payee) of certain foreign source dividend income.

FINDING

Taxpayer's protest is sustained.

II. Equitable Adjustment to Sales Factor Denominator.

In determining the taxpayer's adjusted gross income, the auditor determined that certain gross receipts should be excluded from the sales factor denominator. This determination had the result of increasing taxpayer's tax liabilities for the years at issue. The auditor predicated the decision upon the provisions contained within 45 IAC 3.1-1-50 stating that the particular gross receipts should be disregarded in order "to effectuate an equitable apportionment." Audit Summary, p. 5.

The receipts in question consisted of "Domestic Dividends Subject to 70% Deduction, Dividends 30% not excluded treated as non business income, Wholly Owned Foreign [subsidiaries] Subject to 100% Deduction, Foreign Dividend Gross Up, [and] Interest on U.S. Obligations." Audit Summary, p. 13.

A three-factor (property, payroll, and sales) apportionment formula is used to determine Indiana's taxable share of a multi-state taxpayer's adjusted gross income. 45 IAC 3.1-1-37 et seq. In computing the taxpayer's Indiana sales – both numerator and denominator – only income (receipts) included within a taxpayer's federal gross income and subject to Indiana's adjusted gross income tax may be used. 45 IAC 3.1-1-8. That is, only taxable income may be included in computing the sales apportionment factor.

In this instance, the receipts at issue are not included in the taxpayer's Indiana adjusted gross income. As with all excluded income, such receipts must be excluded from taxpayer's Indiana sales apportionment factors. Specifically, these receipts should not have been included in taxpayer's sales denominator. The auditor correctly determined to

exercise the authority, vested within 45 IAC 3.1-1-50(5), to exclude from the taxpayer's Indiana sales denominator the particular receipts at issue within the taxpayer's protest. Accordingly, audit's decision to exclude those receipts serves to "effectuate an equitable apportionment." Id.

FINDING

The taxpayer's protest is respectfully denied.

III. Addback of State Taxes Based On Or Measured by Income: Michigan Single Business Tax.

In calculating the taxpayer's adjusted gross income, the auditor determined that, for purposes of calculating the taxpayer's liability, taxpayer was required to add back the amount of Michigan Single Business Tax the taxpayer previously paid.

Indiana adjusted gross income tax is imposed upon the adjusted gross income of a corporation that is derived from Indiana sources. IC 6-3-2-1(b). Indiana adjusted gross income is the same as "taxable income" as defined by I.R.C. § 63 and adjusted according to IC 6-3-1-3.5(b). One of those adjustments requires the taxpayer to "[a]dd an amount equal to any deduction or deductions allowed or allowable pursuant to Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States." IC 6-3-1-3.5(b)(3). *See also* 45 IAC 3.1-1-8(3)(a). The taxpayer argues that the Michigan Single Business Tax does not meet the definition of taxes based on or measured by income.

The taxpayer is correct. In First Chicago NBD Corp. v. Dept. of State Revenue, 708 N.E.2d 631 (Ind. Tax Ct. 1999), the court held that the Michigan Single Business Tax was a value added tax which used taxable income as one component in its base calculation. Id. at 633-34. However, because of the extensive adjustments which were made to the individual taxpayer's taxable income in arriving at the Michigan Single Business Tax, the tax "becomes an entirely different tax, one that cannot be fairly read to fit under the 'based on or measured by income' language chosen by the Indiana General Assembly." Id. at 635.

FINDING

Taxpayer's protest is sustained.

IV. Equitable Abatement of Accumulated Interest.

The taxpayer argues that, based upon the purported lengthy delay in responding to the taxpayer's protest letter, it is entitled to have accumulated interest equitably abated.

IC 6-8.1-10-1 imposes upon the taxpayer interest on the amount of unpaid taxes stating that if the taxpayer “incurs a deficiency upon a determination by the department, the person is subject to interest on the nonpayment.” In the absence of any statutory, regulatory, or equitable authority to abate the interest which has accumulated during the pendency of the taxpayer’s protest, the Department must decline the opportunity to do so.

FINDING

The taxpayer’s protest is respectfully denied.

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